

# HOUSE BILL REPORT

## SHB 1495

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### As Amended by the Senate

**Title:** An act relating to the unfair competition that occurs when stolen or misappropriated information technology is used to manufacture products sold or offered for sale in this state.

**Brief Description:** Regarding the unfair competition that occurs when stolen or misappropriated information technology is used to manufacture products sold or offered for sale in this state.

**Sponsors:** House Committee on Judiciary (originally sponsored by Representatives Eddy, Rodne, Kirby, Armstrong, Hunter, Hinkle, Chandler, Pettigrew, Carlyle, Springer, Maxwell, Anderson, Clibborn, Kelley and Kenney).

### Brief History:

#### Committee Activity:

Judiciary: 2/2/11, 2/3/11, 2/17/11 [DPS].

#### Floor Activity:

Passed House: 2/22/11, 90-4.

Senate Amended.

Passed Senate: 4/4/11, 39-8.

### Brief Summary of Substitute Bill

- Creates a new civil cause of action against businesses that use stolen or misappropriated information technology (IT) to manufacture products sold in Washington in competition with products that do not use stolen or misappropriated IT, subject to certain exemptions.
- Allows a court to order that a product made using stolen or misappropriated IT not be sold in Washington or award damages.

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### HOUSE COMMITTEE ON JUDICIARY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 13 members: Representatives Pedersen, Chair; Goodman, Vice Chair; Rodne, Ranking Minority Member; Shea, Assistant Ranking Minority Member; Chandler, Eddy, Frockt, Kirby, Klippert, Nealey, Orwall, Rivers and Roberts.

**Staff:** Parker Howell (786-5793) and Trudes Tango (786-7384).

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*This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.*

## **Background:**

### Consumer Protection Act.

The state's Consumer Protection Act (CPA) prohibits unfair or deceptive acts or practices and unfair methods of competition in the conduct of trade or commerce that directly or indirectly affect the people of Washington. Several statutes specify practices that constitute unfair acts, but they do not provide an exhaustive list. A court may find that conduct not specifically enumerated in statute constitutes an unfair or deceptive act.

Either private plaintiffs or the Attorney General may bring civil actions to enjoin future violations of the CPA or to recover damages caused by an unfair act. Private plaintiffs may recover actual damages and costs, including reasonable attorneys' fees. Courts also may award private plaintiffs damages of as much as three times actual damages, in an amount not to exceed \$25,000.

### "Personal" vs. "In Rem" Jurisdiction.

In order for a court to hear and determine a controversy, it must have jurisdiction over the matter. Often, courts have "personal" jurisdiction over a person sued in a civil lawsuit because the person made certain minimum contacts with the state; for purposes of the CPA, this includes transacting business within Washington.

Foreign defendants whose actions give rise to a lawsuit in a Washington court but who have never visited the state and who have no assets within Washington might not be subject to personal jurisdiction. Yet state courts may have jurisdiction to enter judgment regarding property located within the state, even if the courts do not have personal jurisdiction over that defendant. Such actions against property are called proceedings "in rem."

### Intellectual Property.

Federal and state laws protect certain intellectual property rights in creations, such as computer software (programs) and hardware (equipment). A federal copyright gives the owner of an original work that expresses ideas, such as certain software, exclusive rights to copy, distribute, and adapt the work. A federal patent may protect a publicly disclosed computer-related invention for a period of time. Federal and state trade secret laws prohibit misappropriation of trade secrets, such as formulas, programs, and techniques.

Some holders of software copyrights license other people to modify and redistribute source code for those programs for free. Such programs commonly are called "open source" software.

### Laws in Other States.

In 2010 the Louisiana Legislature enacted a bill making it illegal for a person to develop or manufacture a product or supply a service using stolen or misappropriated property, including software, where the product or service is offered for sale in competition with others

in the state. A breach of the law constitutes a violation of Louisiana's Unfair Trade Practices and Consumer Protection Law.

### **Summary of Substitute Bill:**

A business that manufactures a product while using stolen or misappropriated information technology ("stolen IT") in its business operations engages in an unfair act when the product is sold in Washington, either separately or as a component of another product, in competition with a product made without use of stolen IT. A new cause of action allows private plaintiffs or the Attorney General to sue businesses that engage in these unfair acts.

"Stolen or misappropriated" IT is defined as hardware or software that a business acquired, appropriated, or used unlawfully, unless the hardware or software was not available for stand-alone retail purchase at or before the time it was stolen. A business uses stolen IT in a business operation if it uses the stolen IT to design, manufacture, distribute, market, or sell products.

### Notice.

Before a plaintiff can file suit, the owners of stolen IT must provide written notice to the party allegedly using the stolen IT allowing that party to prove it is not using stolen IT or giving the party 90 days to stop using it, subject to any extensions approved by the owner. The notice must state: (1) the identity of the IT; (2) the identity of the lawful owner; (3) the law allegedly violated and that the notifier reasonably believes the person has acquired, appropriated, or used the IT unlawfully; (4) the manner in which the IT is being used, if known; (5) the products to which the IT relates; and (6) the basis and evidence supporting the allegation.

### Jurisdiction.

A court may proceed *in rem* against certain products only when a court is unable to obtain personal jurisdiction over a party who violated the act.

### Elements of a Claim.

A person is injured by the sale of a product if the person establishes by a preponderance of the evidence that the person:

- manufactures products sold or offered for sale in Washington in competition with articles or products made using stolen IT;
- makes articles or products not manufactured using stolen IT; and
- suffered economic harm, which may be shown by evidence that the retail price of the stolen IT was at least \$20,000.

### Remedy.

If the use of stolen IT continues despite the owner of the stolen IT providing 90 days' notice, an injured person or the Attorney General may bring an action against a person making products using stolen IT to ask the court to enjoin violations of the bill's provisions, including ordering a person not to sell products in Washington. A plaintiff also may ask for the greater of actual damages or an amount of no more than three times the retail price of the stolen IT.

A court may award three times the damages normally allowed when it finds that the defendant willfully used stolen IT. A court also may award costs and reasonable attorneys' fees to the prevailing party in actions brought by an injured person.

The Attorney General or an injured business also may add a claim for actual damages against a third party who sells the products made with stolen IT, but only if a court has determined that a person violated the bill's provisions and entered judgment against him or her and:

- the third party received a copy of the written notice at least 90 days before entry of the judgment;
- the person who violated the bill's provisions did not make an appearance or lacks sufficient attachable assets to satisfy a judgment against him or her;
- such a person either made the final product or a component of it equal to 30 percent or more of the product's final value; and
- the person has a direct contractual relationship with the third party respecting the manufacture of the final product or component.

Damages against a third party must be the lesser of the retail price of the stolen IT or \$250,000.

Before a plaintiff can seek to enjoin products or have a court proceed *in rem*, he or she must show economic injury, defined as a 3 percent price difference between the article made in violation of the bill designed to harm competition and a product that was manufactured without the use of stolen IT, with such a price difference occurring over a four-month period.

If a court determines that a person who violated the bill's provisions lacks sufficient attachable assets in Washington, the court may enjoin sale of products made using stolen IT, subject to certain exceptions.

#### Exceptions.

A person may not sue under this cause of action when: (1) the end product sold or offered for sale in Washington is copyrightable; (2) the product consists of merchandise made by or for a copyright owner displaying elements of copyrighted work or of certain materials; (3) the allegation that the IT is stolen is based on a claim that the IT infringes on patents or misappropriates trade secrets; or (4) the allegation is based on a claim that the use of the IT violates the terms of an open source software license.

A defendant may avoid liability by proving by a preponderance of the evidence that: (1) the person is an end consumer or user, or acquired the product after sale to an end consumer or user; (2) the person is a business with annual revenues of no more than \$50 million; or (3) the person does not have a contractual relationship with the alleged violator.

A third party also may avoid liability by showing that it acquired the products in good faith reliance on a code of conduct governing its manufacturers or written assurances from a manufacturer, or pursuant to an agreement with a manufacturer entered into no later than 180 days after the bill's effective date. The code of conduct or assurances must provide that, within 180 days of notice, the person will take commercially reasonable efforts to confirm the manufacturer is not using stolen IT, require the manufacturer to cease any theft, or prevent future acquisition of products from that manufacturer, where doing so would not

impair certain contracts. If the third party relies on an agreement with a manufacturer, the third party also must make these commercially reasonable efforts to require the manufacturer to cease theft or to stop acquisition from that manufacturer. As an alternative, a third party may avoid liability by showing that it made commercially reasonable efforts to implement practices and procedures to require direct manufacturers not to use stolen IT. A third party may satisfy this by adopting a code of conduct that prohibits use of stolen IT subject to audit rights or adopting a code of conduct that prohibits use of stolen IT and undertaking procedures to address compliance with that code of conduct.

A court may not enforce a damage award against a third party for a period of 18 months from the bill's effective date.

#### Consumer Protection Act.

The bill creates remedies exclusive of the Consumer Protection Act.

#### **EFFECT OF SENATE AMENDMENT(S):**

The Senate amendment makes the bill identical to the Senate companion bill as passed by the House Judiciary Committee. The Senate amendment: (1) adds mask works protection to the definition of "copyrightable end product;" (2) clarifies notice to third parties must be properly served to the third party's agent for service of process; (3) specifies when the court may award litigation expenses incurred by a third party; (4) provides that for the affirmative defense based on issuing written directives to the manufacturer, the third party need take no additional action to avail itself of this defense; (5) provides that for purposes of the court dismissing an action because of a previous action adjudicated in another jurisdiction, the dismissal is final and no other action may be brought against the manufacturer or third party; and (6) specifies that the damages that may be awarded against a manufacturer or third party are "direct" damages.

**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date:** The bill takes effect 90 days after adjournment of the session in which the bill is passed.

#### **Staff Summary of Public Testimony:**

(In support) This bill would deal with information piracy and use of stolen IT in production of goods. Extensive changes to the bill already have been made, reflecting the fact that discussions are ongoing among several companies about exactly how the legislation should be shaped. Jobs are moving abroad as manufacturing moves overseas. This bill would apply to the use of stolen IT wherever it takes place. By the end of the year, China is expected to surpass the U.S. as the largest market for personal computers in the world; but the Chinese do not buy as much software as U.S. consumers, instead using illegal copies. Meanwhile, China exports billions of dollars worth of goods to the U.S. This bill represents a simple proposition: if you are going to sell us your goods, please stop stealing our property. Thousands of U.S. jobs are lost because of piracy of Microsoft products alone.

Proponents of the bill really want people to use the "safe harbors" in the bill, such as use of vendor codes of conduct and audits. This bill is an experiment. It puts the onus on U.S. companies to tell their suppliers that to continue doing business, they must have anti-piracy agreements in place. Small companies should not be liable under the bill, as long as they have annual revenues of less than \$50 million or meet other criteria. This bill does not shift the burden of proof away from the plaintiff or change discovery rules. Microsoft hopes a number of states will pursue this legislation.

(With concerns) The bill holds retailers responsible for the misdeeds of suppliers. It could be easy to bring suit, but expensive to defend such suits under the bill's provisions. The definition of manufacturer may need to be improved.

(Opposed) The bill will have unintended consequences. The bill is not ready yet. Certain production runs are done as one-offs by overseas manufacturers at the last minute, not allowing for use of certain safe harbors. Newspaper publishers should not be held guilty until proven innocent. The bill intrudes into a newspaper company's business affairs.

**Persons Testifying:** (In support) Representative Eddy, prime sponsor; and Brad Smith, Microsoft.

(With concerns) Mark Johnson, Washington Retail Association.

(Opposed) Vans Stevenson, Motion Picture Association of America; and Rowland Thompson, Allied Daily Newspapers.

**Persons Signed In To Testify But Not Testifying:** None.